

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Battin Analyst: LuAnna Hass Bill Number: SB 914  
Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: 02-23-2001  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Nonretardant Fire Material Roof Replacement Credit

### SUMMARY

This bill would allow a credit for the cost of replacing an inflammable roof with a fire retardant roof material.

### PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to give all taxpayers in California an incentive to become more proactive for fire safety measures.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and specifies that it would be operative for taxable years beginning on or after January 1, 2001, and before January 1, 2006.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake or to reduce the financial burden of those actions.

Existing state and federal laws generally allow a depreciation deduction to the owner for the obsolescence or wear and tear of property used in a business or investment property, including residences used as rentals. The amount of this deduction is determined, in part, by the cost (or basis) of the property. In addition, the property must have a limited, useful life of more than one year. Depreciable property includes equipment, machinery, vehicles, and buildings, but excludes land. Significant improvements to property increase the basis of the property and are depreciated over its remaining useful life.

#### Board Position:

\_\_\_\_ S      \_\_\_\_ NA      \_\_\_\_ NP  
\_\_\_\_ SA      \_\_\_\_ O      \_\_\_\_ NAR  
\_\_\_\_ N      \_\_\_\_ OUA      \_\_\_\_ X PENDING

#### Department Director

#### Date

Alan Hunter for GHG

04/04/01

Personal residences are not depreciated under state and federal law. However, improvements may increase the basis of the residence. When it is subsequently sold, gain or loss is determined by reference to the adjusted basis of the property for tax purposes.

### THIS BILL

This bill would allow a credit of 20% of the qualified cost that is paid or incurred during a taxable year to replace a roof that consists of nonretardant fire materials with a fire retardant roof. The replacement roof must be composed of a fire retardant material that is prescribed by the Office of the State Fire Marshal. The credit is limited to \$1,000 for a residential dwelling in this state that is owned by the taxpayer during the taxable year. Any unused credit may be carried over to the following year.

The term “qualified cost” is defined as the difference in cost between replacing the roof with a fire retardant material versus a nonretardant material, including the cost of materials and labor.

### IMPLEMENTATION CONSIDERATIONS

This bill allows a credit equal to 20% of the qualified cost, not to exceed \$1,000, to replace a roof composed of nonretardant fire material. It is unclear whether the credit may not exceed \$1,000 or the cost to replace the roof may not exceed \$1,000 (resulting in a \$200 maximum credit). The bill needs to be amended to clarify the limitation.

This bill is limited to taxpayers that replace a roof composed of nonretardant fire material on a residential dwelling. The terms “nonretardant fire material” and “residential dwelling” are not defined. Undefined terms could lead to disputes with taxpayers and will complicate implementation and administration of this credit.

### **LEGISLATIVE HISTORY**

AB 109 (Kaloogian, 1997/98) would have allowed a deduction equal to 20% of the cost to replace a residential roof of nonretardant fire materials with a fire retardant roof. This bill failed to pass out of the first house by January 31st of the second year of the session. AB 77 (Morrow, 1997/98) would have allowed a credit of 50% for the replacement of a residential wood shake roof with a new roof composed of fire resistant materials. This bill failed to pass out of the first house by January 31st of the second year of the session.

### **OTHER STATES' INFORMATION**

Review of Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws found no comparable tax credits or deductions. These states were reviewed because of the similarities between California income tax laws and their tax laws.

### **FISCAL IMPACT**

If the bill were amended to resolve the implementation considerations addressed in this analysis, this bill would not significantly impact the department's costs.

## ECONOMIC IMPACT

### Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of SB 914 As Introduced 2/23/01 [\$ In Millions]		
2001-02	2002-03	2003-04
-\$57	-\$65	-\$67

Estimates assume the maximum credit per roof replacement is \$1,000. Note that as drafted, a literal interpretation of the language defining qualified costs could be that there are no qualified costs, as a taxpayer could not legally replace a roof in California with non-fire rated materials.

### Tax Revenue Discussion

Qualified costs and the amount of credits that could be applied to reduce tax liabilities would determine the revenue impact of this bill.

As drafted, the bill does not define “fire-retardant materials.” Industry test standards generally classify both materials and rated roof assembly into classes A, B, or C, ranked in order of decreasing fire resistance. According to staff at the Office of the State Fire Marshal, the minimum fire resistance rating for new or replacement roofs throughout California is class C. The Fire Marshal's staff further indicated that a replacement roof meeting test standards of classes A, B or C would qualify as fire-retardant materials under this bill. Treated wood shakes could meet the test standards of classes A, B, or C, depending upon the rated roof assembly.

The cost to replace a roof on single story home of average size with fiberglass shingles is approximately \$7,500, and with premium materials, it increases to \$12,000 or more. Approximate market share for roof replacements is 80% fiberglass shingle, 15% premium material, and 5% wood shake.

Assuming an average of 24 roofing squares and qualified costs of approximately \$125 per square derives total qualified costs of roughly \$3,000 per roof replacement. Multiplying qualified costs of \$3,000 by the proposed credit of 20% derives an average credit of \$625 in 2001. For subsequent years, the average credit amount is grown by 3% each year to reflect rising material/labor costs.

Housing estimates available from Department of Finance indicate there are roughly 8.4 million residential units in California (single detached and attached residential units and multiple residential units with two to four units). Industry sources indicate that perhaps a quarter of the 8.4 million residential units in California have non-fire rated roofs. The estimated useful life of a non-fire rated roof is 15 to 25 years. Assuming the mid-point of 20 years suggests that 5% of non-fire rated roofs are replaced in any given year. Combining this information derives a projection of roughly 105,000 non-fire rated roofs are replaced in any given year [8.4 million x 25% x 5%].

Multiplying the average credit amount by the number of non-fire rated roofs replaced in any given year derives the amount of credits generated each year. It is assumed that 80% of credits generated would be applied in the year generated. Credit balances would be carried over and applied in the next tax year.

### **ARGUMENTS/POLICY CONCERNS**

Conflicting tax policies come into play whenever a credit is provided for an item that is already deductible as a business expense or is otherwise reflected as an adjustment to the basis of property for tax purposes. Providing both a credit and allowing the full amount to be deducted (or added to basis) would have the effect of providing a double benefit for that item of cost. On the other hand, making an adjustment to deny the deduction or reduce basis in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general conformity policy.

### **LEGISLATIVE STAFF CONTACT**

LuAnna Hass  
Franchise Tax Board  
845-7478

Brian Putler  
Franchise Tax Board  
845-6333